Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Connect America Fund	)	WC Docket No. 10-90
	)	
High-Cost Universal Service Support	)	WC Docket No. 05-337

EATEL APPLICATION FOR REVIEW OF ACTION TAKEN PURSUANT TO DELEGATED AUTHORITY

I. INTRODUCTION AND SUMMARY

Pursuant to Section 1.115 of the Commission's rules,[1] East Ascension Telephone Company, LLC ("EATEL")[2] hereby seeks Commission review of the Order of the Wireline Competition Bureau ("Bureau") released on April 25, 2012 in the above-captioned proceedings.[3] The Order adopts a methodology for establishing benchmarks for high-cost loop support ("HCLS") in order to implement a rule that the Commission adopted in its

1 47 C.F.R. § 1.115.

2 EATEL is a provider of incumbent local exchange telephone services in southern Louisiana. It is a family-owned and operated company that has been providing a wide range of telecommunications services to Ascension and Livingston Parish communities for more than 75 years. EATEL purchased Vision Communications (parent company of Lafourche Telephone Company) in January 2012, through which EATEL provides incumbent local telecommunications services, cable operations, and competitive local exchange services to a service area throughout southeastern Louisiana, extending from lower Livingston Parish to southern Jefferson Parish. Declaration of John Scanlan ¶2.

3 *See Connect America Fund, High-Cost Universal Service Support*, Order, WC Docket Nos. 10-90 and 05-337 (rel. April 25, 2012) ("Order").

USF/ICC Transformation Order intended to limit the reimbursement of expenses of cost-based rate-of-return ("ROR") local exchange carriers ("LECs") with relatively high costs.[4]

The Order should be overturned by the Commission and not allowed to take effect on July 1. The Commission ordered the Bureau to employ statistical techniques to determine which companies should be deemed similarly situated, and to compare the costs of similarly situated companies.[5] The Bureau has employed techniques that are unreliable by any objective measure. As applied to EATEL, the Bureau has erred in its development of independent variables for use in its quantum regression analysis ("QRA") or in its application of the QRA to EATEL, or both. Without access to the underlying data and methods used by the Bureau, it is impossible to recreate the results reached by the Bureau, but EATEL believes there is ample evidence that the results constitute reversible error.

As applied to EATEL, the Bureau's use of the QRA produces an anomalous 73.4% reduction in HCLS, reducing EATEL's operating cash flow by nearly one-third. This reduction in support will significantly impair EATEL's ability to continue investing in broadband, and could even threaten the maintenance of essential voice telecommunications and emergency services. Simultaneously herewith, EATEL is filing a Petition for Stay of the Order's effectiveness, reflecting the imminent threat to EATEL's operations that the Order

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[4] Order ¶1, *referencing Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and Reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support; Developing a Unified Intercarrier Compensation Regime; Federal-State Joint Board on Universal Service; Lifeline and Link-Up; Universal Service Reform—Mobility Fund*; WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, 26 FCC Rcd 17663 (2011) ("USF/ICC Transformation Order "); *pets. for review pending sub nom. In re: FCC 11-161*, No. 11-9900 (10th Cir. Filed Dec. 8, 2011).

[5] USF/ICC Transformation Order ¶217.

represents. In light of the impending July 1 implementation date, EATEL respectfully requests expedited action on this Application.

II. BACKGROUND

Following the adoption of the benchmarking rule in the Commission's USF/ICC Transformation Order,[6] the Commission sought comment on a methodology to limit reimbursable capital and operating costs within HCLS, and to redistribute the amounts to other LECs for broadband investment.[7] The Commission directed the Bureau to finalize such a methodology in short order, to be effective by July 1, 2012.[8] The Commission provided the Bureau with the parameters of the methodology to be used in limiting payments from HCLS, specifically requiring that the companies' costs be compared with the costs of similarly situated companies, and that "statistical techniques should be used to determine which companies shall be deemed similarly situated."[9] In employing statistical techniques, the Commission permitted the Bureau to consider a non-exhaustive list of variables for purposes of the analysis, and gave the Bureau discretion to include additional variables.[10]

In the Order, the Bureau estimates that implementation of its benchmarking methodology will result in HCLS reductions of approximately $65 million in roughly 100

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6 EATEL actively participated in the proceedings leading to the USF/ICC Transformation Order as well as in the subsequent proceedings in which the Bureau sought comment on its QRA. *See, e.g.,* Further Comments of the Small Company Committee of the Louisiana Telecommunications Ass'n in WC Docket Nos. 10-90 *et al.,* filed August 24, 2011; Reply Comments of the Small Company Committee of the Louisiana Telecommunications Ass'n in WC Docket Nos. 10-90 *et al.,* filed Feb. 17, 2012; Reply Comments of the Small Company Committee of the Louisiana Telecommunications Ass'n in WC Docket Nos. 10-90 *et al.,* filed March 30, 2012.

7 USF/ICC Transformation Order ¶1081.

8 *Id.* ¶210.

9 *Id.* ¶217.

10 *Id.*

study areas.[11] Approximately 19.6 percent of that reduction will be borne by EATEL alone. Reductions in HCLS pursuant to the Order are scheduled to begin July 1, 2012 on a phased-in basis, with the changes fully implemented beginning January 1, 2014.[12]

III. ARGUMENT

A. The Bureau Failed To Employ Statistically Reliable Techniques, As Ordered By the Commission

The Bureau defends the QRA adopted in the Order by pointing out that it resolves some defects in the regression analysis originally proposed by the Commission.[13] However, the Bureau admits that the methodology it adopts in the Order suffers from relatively weak predictive power. The Bureau reveals that the pseudo R-squared values in the methodology adopted are approximately 67 percent for capital expenses and 62 percent for operating expenses.[14] While unquestionably an improvement over the 27 to 59 percent pseudo R-squared values in the proposed methodology, these numbers simply do not establish that the methodology adopted by the Bureau is statistically reliable. Indeed, it is widely recognized that pseudo R-squared values should be upwards of 90 percent before a method can be said to be reliably predictive.[15] On this basis alone, the Order should be reversed. Some of the key reasons for this lack of reliability are identified below.

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11 Order ¶4.

12 *Id.* ¶5.

13 *E.g.,* Order ¶67 ("Because the final methodology uses two regressions rather than eleven, the values of the dependent variables are never less than or equal to zero, as was the case for many of the values in the algorithm step 8 regression as originally proposed in the *FNPRM*").

14 Order ¶69.

15 *See, e.g.,* R. Koenker, "Assessment of FCC Quantile Regression Methods for Estimation of Reimbursable Cost Limits," Comments of the Nat'l Exchange Carrier Ass'n *et al.* in WC Docket Nos. 10-90 *et al.,* App. E, filed Jan. 12, 2012.

B. <u>The Independent Variables Used By the Bureau Are Unreliable</u>

In simple terms, a regression analysis assumes that a dependent variable (cost per loop) can be reliably estimated by reference to a set of independent variables (*e.g.,* number of loops, density, geography). The reliability of a statistical regression analysis thus very much depends on the quality of the independent variables employed. For its independent variable inputs, the Bureau appears to have used inaccurate and incomplete data from a number of sources, and inappropriately applied statistical techniques. The results of their efforts, therefore, are not predictive and should be rejected by the Commission.

One example of the use of inaccurate data that has a detrimental effect cascading through the Bureau's methodology is the use of census block "centroids" to determine which census blocks should be assigned to each LEC study area.[16] Rather than using actual study area boundaries in its analysis, the Bureau used census block footprints, assigning each census block to the study area based on the wire center where the census block centroid is located.[17] This single decision impacted the quality of several of the independent variables used in the QRA, including the study area square miles, the number of road miles in each study area, and the number of road crossings in each study area. These variables, in turn, were essential in calculating additional variables used by the Bureau, including study area scale,[18] geographic variables such as proximity to bedrock,[19] and construction values.[20] Where such a significant number of independent variables are unreliable, the entire data set may be useless, as each carrier's costs per loop are compared to those of all the other LECs.

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16 Order ¶73.
17 *Id.*
18 *Id.* ¶85.
19 *Id.* ¶94.
20 *Id.* ¶87.

It is essential to the reliability of the QRA and its output, therefore, that the Bureau's initial decision to use census block centroids to define the study area boundaries be a reasonable choice. Unfortunately, it was not.

NECA supplied a study that showed that the Tele-Atlas wire center boundary data used by the Bureau was riddled with inaccuracies.[21] Incredibly, the Bureau acknowledged the inaccuracies in the data on which it relied, but proceeded to use the data anyway. Carriers adversely affected by a reduction in support may seek a waiver to correct the inaccurate calculations, the Bureau said.[22] And the Bureau will continue to work on the data, hoping to have improved inputs by 2014.[23] This is an unacceptable resolution for a company that is facing the loss of one-third of its operating cash flow. Given the grossly flawed data on which the Bureau's calculations are based, the Commission should not allow the Order to take effect on July 1.

Other important independent variables were used incompletely or incorrectly. For example, the Bureau recognized that carriers in some areas face unique challenges of geography, but drew from data sets that were so broad that they fail to convey meaningful costs differences between otherwise similarly situated carriers.[24] There is no explanation for why other locations were not deemed "significant" for purposes of operating expenses. The devastation suffered by southern Louisiana, and other Gulf Coast states, from Hurricane Katrina, Hurricane Gustave, and the repercussions of the Gulf oil spill, forced significant costs on LECs operating in this region of the country, and should have been deemed a

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21 Comments of the Nat'l Exchange Carrier Ass'n *et al.* in WC Docket Nos. 10-90 *et al.,* App. D, 3-4, filed Jan. 12, 2012.

22 Order ¶27.

23 *Id.*

24 The staff only included regional cost variables for two of the four regions – Midwest and Northeast – in the model. *See* Order ¶23.

"significant" variable.[25] Similarly, the "soil difficulty index" was used selectively to provide for higher construction costs in areas with close-to-the-surface bedrock, yet the record shows that some LECs in areas with very significant bedrock actually have lower construction costs, preferring above-ground to buried cabling.[26] Importantly, though EATEL serves a region not known for close-to-the-surface bedrock, it is forced to bury its cable due to high frequency of hurricanes and similar wind and water events, even while it must elevate its electronic equipment high above ground to avoid the flood plain.[27] For these reasons, EATEL believes that the Bureau may have incorrectly applied the geography-specific variables to EATEL. Without access to the Bureau's underlying calculations, however, it is impossible to verify how the Bureau arrived at the results of its QRA.

C. Some Independent Variables Used By the Bureau Cannot Be Verified

In order for any carrier to understand why its costs are deemed non-reimbursable under the Bureau's calculations, it is necessary to know what variables were used, and how they were used. This is impossible under the Order. In a number of cases, the Bureau has not revealed the underlying inputs used or their methodology for computing independent variables, either because they relied on multiple underlying data sources or because they modified the source data. In either case, they have not made public the process they used to arrive at the specific inputs selected. For example, EATEL has been unable to determine what road miles and road crossings from the ESRI ArcGIS Street Map were used, or how the Bureau calculated construction values for EATEL from the application of the STATSGO2

25 EATEL's service area has become a government agency and emergency services gathering point after both Hurricane Katrina and the British Petroleum oil spill. Declaration of John Scanlan ¶5.

26 Order ¶96.

27 Declaration of John Scanlan ¶3.

database to the study area road data. This makes it impossible for EATEL to determine if the data used to develop the cost recovery limits were inaccurate or used improperly in the statistical analysis.

EATEL has requested access to these input values,[28] but thus far access has not been granted. If EATEL is to derive any lesson from this exercise to help it "invest prudently and operate efficiently," as the Commission intended,[29] it must understand how changing any particular variable would be likely to change the outcome. The Bureau has not made that possible.

D. The Bureau Has Improperly Calculated the Dependent Variables To Reduce Reimbursement Of Loop Costs Prudently Incurred

The Bureau used the results of its QRA to identify LECs with capital and operating costs "much higher than those of their similarly situated peers," and capped recoverable costs using a benchmark of 90 percent.[30] EATEL does not believe the Bureau justified the decision to benchmark "appropriate" costs at the 90th percentile. Even more surprising, however, are some of the Bureau's choices of components in the operating expense calculation.

The Bureau committed a critical error in choosing allocated loop costs, rather than the total unseparated costs, for the purpose of calculating operating expenses.[31] HCLS is intended to reimburse carriers for costs prudently incurred in deploying, operating, maintaining and upgrading network loop plant. *Allocated* loop costs are determined by Part 36 of the Commission's rules, but the QRA is intended to estimate total *actual* (historic) costs.

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28 Letter from Arthur G. Scanlan II and John Scanlan, EATEL, to Sharon Gillett, Chief, Wireline Competition Bureau, WC Docket Nos. 10-90 *et al.,* filed May 1, 2012.
29 USF/ICC Transformation Order ¶¶214, 219.
30 Order ¶32.
31 *See* Order n. 44.

Similarly, the Bureau erred in including operating taxes in the opex calculation, not just because they are out of the LEC's control, as the Bureau noted, but especially because they are not paid by all ROR LECs. While the Bureau may be right in observing that all LECs share many costs that are beyond their control, such as the cost of copper and the cost of labor,[32] it also is the case that all LECs *pay* those costs to some extent, whereas many small LECs – such as municipally-owned and cooperative LECs – are largely tax-exempt.

The result of these combined errors is that the Bureau's QRA is unreliable.[33] As explained above, while EATEL bears the largest share of the burden of these errors, they impact all of the ROR carriers and thus threaten the integrity of the Commission's HCLS fund.

E. The Order's Errors Affect All ROR LECs, But Have Disproportionately Impacted EATEL

The Bureau estimates that implementation of its benchmarking methodology will result in HCLS reductions of approximately $65 million for the roughly 100 study areas, of which an abnormally large portion -- 19.6 percent -- will be borne by EATEL.[34] EATEL's HCLS receipts for 2011 were $17,398,768. Under the benchmarks adopted by the Bureau, EATEL's annual HCLS draw will be reduced by $12,766,899, roughly 73.4 percent. This in turn will reduce EATEL's operating cash flow by nearly one-third. A reduction of this kind would undoubtedly cause significant operational issues for the company, resulting in grave consequences for EATEL customers and employees. EATEL believes that its ability to

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32 *Id.*

33 Indeed, EATEL ran a test of the QRA using total unseparated costs and excluding taxes, and the resulting 90% opex per-loop estimate is *above* EATEL's actual current opex. Declaration of John Scanlan ¶8.

34 About 500 study areas are estimated to see approximately $55 million in additional broadband investment support. Order ¶5.

attract capital to continue investing in broadband, and even its maintenance of existing services, are threatened by this action.[35]

The devastating financial impact that the Order will have on EATEL's HCLS and operating cash flow underscores the urgent need for Commission review. It defies logic that one small carrier serving only portions of two Louisiana parishes with a total population of less than 240,000 residents would bear a near 20% brunt of the reduced USF support resulting from the Order.

IV. CONCLUSION

For the foregoing reasons, EATEL urges the Commission to find there is good cause to grant this application for review, and reverse the Bureau's Order.

Respectfully submitted,

/s/

John Scanlan
President and Vice Chairman
EAST ASCENSION TELEPHONE COMPANY, LLC
913 S. Burnside Avenue
Gonzales, Louisiana 70737-4258
(225) 621-4300

Karen Brinkmann
Robin Tuttle
KAREN BRINKMANN PLLC
555 Eleventh Street, NW
Mail Station 07
Washington, D.C. 20004-1304
(202) 365-0325
KB@KarenBrinkmann.com

Counsel for EATEL

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35 The suddenness of this change is as devastating as the magnitude of the support involved. EATEL calculated that under the proposed QRA, it would have suffered a reduction of approximately $540,968 of its annualized HCLS. Declaration of John Scanlan ¶9.